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TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
DECEMBER 10, 2004 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:
- No Change in Interest Rates;
- IMF Seep Progress in Economic Fundamentals but Inequality Still Problematic;
- 39 Percent of Manufacturers Have Closed Export Capacity;
- SA's Labor Force Declines Due to Discouragement and HIV/AIDS;
- BEE Transactions Double Though Benefiting Few;
- October Manufacturing Growth Leveled;
- Current Trade Conditions Still Predict Growth;
- Net Reserves Increase by 14 Percent in November; and
- Union Criticizes Motor Vehicle Sector's BEE Exemption.
End Summary.

NO CHANGE IN INTEREST RATES

¶2. The South African Reserve Bank's (SARB) Monetary Policy Meeting (MPC) kept its key lending rate steady at 7.5 percent, mostly in line with market forecasts. This means the prime rate remains at 11 percent. SARB's governor Tito Mboweni expects inflation could increase somewhat in 2005, but should remain comfortably within the target range of 3 to 6 percent. Mboweni cited the following indicators as possible future reasons for an increase in inflation: (1) the decline in growth of labor productivity from 3.3 percent in the first quarter 2004 to 0.5 percent in the second quarter; (2) the recent strong growth in money supply (14.9 percent in October); and (3) the high growth of total loans of the banks to the private sector (15.1 percent in October). Combined with strong growth in demand in the third quarter, the MPC left interest rates unchanged. Two thirds of economists surveyed by I-Net Bridge expected no change in rates, while the rest forecasted a 50 basis points cut. The announcement came at the same time that the Bureau for Economic Research at the University of Stellenbosch released its findings of the inflation expectation survey. The survey differed very little from the third quarter, with overall inflation expectations remaining in the SARB's 3 to 6 percent target range for a second time in a row. Source: I-Net Bridge, December 9; Statement of the Monetary Policy Committee, December 9.

¶3. Comment. Even though the rand has strengthened 5.1 percent against the dollar in November alone, fears that strong consumer demand along with wage increases already negotiated being just above the 6 percent range made the SARB reluctant to reduce interest rates just before the holiday season. Recent press statements by SARB Governor Mboweni emphasized that the Bank would not lose its focus in targeting inflation. End comment.

IMF SEES PROGRESS IN ECONOMIC FUNDAMENTALS BUT INEQUALITY STILL PROBLEMATIC
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¶4. The International Monetary Fund (IMF) released its annual report on South Africa and noted that South African growth should increase over the short to medium term as monetary easing, a moderate expansionary fiscal policy, increases in investment and strong domestic demand provide a solid base for over 3 percent growth. The IMF expects a modest increase in inflation over the next twelve months and views adjustments in interest rates likely. The IMF views recent increases in South Africa's net international reserves as crucial since the closure of the SARB's forward book in the foreign exchange market in February 2004, and considers further increases in reserves as desirable in order to help reduce currency volatility and keep long-term interest rates low. In response to strong domestic demand and the currency appreciation, the external current account position reversed from a surplus of 0.6 percent of GDP in 2002 to a deficit of 0.8 percent

of GDP in 2003; however, South Africa continues to attract inflows to easily finance its current account deficit. Increased government expenditures have provided counter cyclical support and helped address South Africa's social problems. "The authorities agree that a government deficit in the region of 3 percent of GDP should be considered the upper limit of what is desirable to maintain macroeconomic stability and to keep indebtedness under control," the IMF said. Universal provision of antiretroviral HIV/AIDS drugs through the public health system is an important example of increased government expenditures. The annual report also emphasizes the importance of policies designed to reduce income and wealth disparities and encourages progress in both black empowerment programs and land reform as being crucial to maintain social cohesion. In order to reduce unemployment, the IMF report stated that labor market and tax reforms and increased competition were necessary. The IMF staff recommends that steps be considered to decentralize the collective bargaining system so that small and medium-sized enterprises gain more autonomy in setting wages. It is, moreover, concerned that increases in minimum wages have aggravated the unemployment problem, particularly in the agricultural sector. "The government's skills development program could be strengthened by relying less on labor levies as a source of funding and by focusing more on training those presently unemployed," the IMF said. The IMF staff urged that further liberalization of the tax regime be undertaken and that implementation of the privatization program, which has come to a halt, be stepped up. Source: I-Net Bridge, December 2.

39 PERCENT OF MANUFACTURERS HAVE CLOSED EXPORT CAPACITY
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¶5. Thirty-nine percent of South African manufacturers have closed down export capacity permanently over the past two years as the rand has moved from above 13 rand per US dollar in December 2001 to below 6 rand per dollar. The Bureau of Economic Research (BER) at the University of Stellenbosch found these results during its survey of 1,100 manufacturers conducted between October 25 and November 22. Other survey results included: (1) 28 percent "suffered a decline in export volumes"; (2) 16 percent managed to maintain export markets, if not grow them; and (3) 14 percent managed to "continue growing export volumes" over the past two years. The BER noted that the global economy has been in a growth phase over the past 18 months, with growth being exceptionally strong during the second half of 2003 and the early part of 2004. In some sectors, production for export is being switched to the domestic market as 25 percent of the respondents indicated that this has been their company's response over the past two years. Since the manufacturing sector contributed more than half of export revenues in 2003, the implied loss of export capacity suggests larger economic costs tied to the strength of the currency. BER expressed concern that the strong rand is indirectly fueling domestic expenditure while constraining local production (because of the low cost of imports) leading to unbalanced and unsustainable growth. It recommends that the South African Reserve Bank (SARB) should accumulate reserves more aggressively. The SARB should also consider easing interest rates to close the gap with interest rate levels abroad, currently inviting volatile money inflows on the capital account of the balance of payments. When asked to give their view on what constituted the optimal level of foreign reserves for South Africa, 48.9 percent of the survey participants said six months import cover, 28.9 percent said one year's import cover, 16.7 percent said three months import cover and only 5.6 percent said three years' worth. Source: I-Net Bridge, December 2.

SA'S LABOR FORCE DECLINES DUE TO DISCOURAGEMENT AND HIV/AIDS
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¶6. South Africa's labor force has declined over the past few years, probably because more people have given up looking for work or are infected with HIV, says a new report in the South African Reserve Bank's (SARB) Labor Market Frontiers report. South Africa's labor force participation rate, which counts the number of people working and actively seeking work as a proportion of the total population, dropped to 54.1 percent in September 2003, down from 58.9 percent in September 2000. Official figures from Statistics SA show that unemployment dropped to 4.6 million in September 2003 from 5.3 million in March 2003, based on the narrow definition of unemployment where an individual had been actively seeking work prior to the survey. The drop in unemployment was not matched by an increase in total employment over that period, with more people dropping out of the labor market. The number of discouraged job seekers increased the unemployed figure to more than 8 million. The SARB's report states that job seekers were discouraged because of the slim chances of

finding a job, or because they lacked funds to search actively for work. Another likely cause for a drop in labor market participation was the effect of HIV/AIDS. The report points to research that shows a drop in HIV/AIDS prevalence among younger people in their twenties, and an increase in higher age groups, making up most of the labor force. The report also assesses whether social grants have a negative incentive on labor force participation, but found mixed results. Some studies show that pension payments cause an indirect effect of withdrawal from the labor market. However, other studies show that a child support grant could result in higher labor force participation. Source: Business Day, December 3.

BEE TRANSACTIONS DOUBLE THOUGH BENEFITING FEW

¶7. Black economic empowerment deals this year increased to an estimated R80 billion ($14 billion using 5.7 rands per dollar) amid debate that only a small black elite was benefiting from the transactions. This was more than double the R40 billion worth of empowerment deals concluded last year, fuelled mainly by black economic empowerment charters. Trade and Industry Minister Mandisi Mpahlwa stated that 72 percent of last year's deals had involved at least one of the top six empowerment companies, Mvelaphanda, Shanduka, ARM, Kagiso, Tiso and Safika, adding weight to concerns that government's current empowerment strategy is not broad-based enough. Trade and Industry Deputy Director-General Lionel October estimated that the number of recorded deals had doubled this year from last year's 118. Apart from the financial sector, key sectors contributing to the huge deal-making this year included information technology, retail and manufacturing. Mpahlwa said the average reported value of all the transactions last year was R515.3 million ($90 million), and the largest transaction in terms of rand value last year was the ARMGold and Avmin deal worth R10.6 billion ($1.86 billion). The use of vendor financing, inflows of foreign capital and the involvement of the Industrial Development Corporation were among the financing mechanisms used. Source: Business Day, December 7.

OCTOBER MANUFACTURING GROWTH LEVELS

¶8. Both manufacturing production and sales declined on a monthly basis (seasonally adjusted) at -0.7 and -1.0 percent, although when compared to figures from last October, they grew 5.3 and 11.4 percent respectively. October 2004's year-on-year growth shows high growth compared to a low base last October. The manufacturing sector experienced a recession from April 2003 to February 2004, and October 2003's manufacturing production declined by 2.3 percent. On a quarterly basis, 7 out of 10 sectors reported improvements, with the greatest contribution to manufacturing output growth coming from food and beverages. Production growth was also strong in the motor vehicle, paper, wood, and furniture industries. The textile sector and communication equipment reported the largest decline in both production and sales, as competition from cheaper imports is especially severe in these industries. Source: Standard Bank, Manufacturing Unpacked December 7; Business Day, December 8.

CURRENT TRADE CONDITIONS STILL PREDICT GROWTH

¶9. Started in 2000, the South African Chamber of Commerce and Standard Bank publish two monthly trade indices measuring South African trade activity and expectations. November's indices still indicate growth, although expectations have marginally decreased from October's level. The trade activity index increased to 56 compared to October's level of 50, with sales volumes and new orders showing the highest growth in November. Sales volumes indicate strong November growth even when seasonally adjusted, confirming that domestic demand growth remains quite strong. The survey showed that inflation (selling prices) slowed in November, although purchase prices (prices of inputs) increased. Since 2000, the employment component of the activity index has rarely exceeded 50, a value indicating expansion in employment. November's value of 51 indicates modest expansion, although employment growth may reflect seasonal increased hiring. The trade expectations index also predicts expansion at 60, although it has declined marginally from September and October's values of 63 and 61 respectively. There is strong expectation that growth in both sales volumes and new orders will increase over the medium term, although not as strong as in October. Traders expect that both selling and purchasing prices will increase over the medium term, with selling price increases moderating. Employment prospects remain positive at 53, the fourth

consecutive month of expanding employment expectations. Source: Standard Bank, SATMI, December 7; Business Day, December 8.

NET RESERVES INCREASE BY 14 PERCENT IN NOVEMBER

¶10. The South African Reserve Bank's (SARB) net reserves increased by 14 percent in November to $11.02 billion. The SARB increased its purchases to $1.3 billion compared to its October purchase of $962 million. Gross gold and foreign exchange reserves increased to $14.425 billion compared to October's level of $13 billion. According to Nedcor economist Magan Mistry, the current level of reserves will cover about four months of imports and Mistry expects that the bank will continue to increase reserves until six months of imports are covered. On average, the rand appreciated 5.1 percent against the dollar in November, and with continuing rand strength and higher gold prices, further increases in reserves are expected in December. Source: Standard Bank, Foreign Reserves Alert, December 7; Business Report, December 8.

UNION CRITICIZES MOTOR VEHICLE SECTOR'S BEE EXEMPTION

¶11. The National Union of Metalworkers of SA (NUMSA) has criticized the motor sector's original equipment manufacturers' exemption from Black Economic Empowerment (BEE) since the companies were not South African-based. In October, Trade and Industry Minister Mpahlwa stated that the government would allow multinationals in the motor vehicle sector to commit to their own BEE initiatives rather than forcing them into a single approach. Since multinationals comprised the majority of the vehicle assembly and component manufacturing sectors and alliances were formed with both upstream and downstream producers, government was open to negotiation regarding BEE ownership requirements for original equipment manufacturers. NUMSA views that since these companies derive benefits from the government's motor industry development program, they should not be exempt from following the government's BEE policies. NUMSA wants to establish an empowerment charter, code of conduct, standards and monitoring mechanisms for the industry as a whole. Nico Vermeulen, executive director of the National Association of Automobile Manufacturers of SA reported that representatives of the motor vehicle industry were finalizing a sectoral approach to BEE and expects additional discussion with all stakeholders in the near future. Source: Business Report, December 8.

FRAZER